TRANSCRIPT OF RECORD

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1941

No. 151

THE UNITED STATES OF AMERICA, PETITIONER

vs.

JOLIET & CHICAGO RAILROAD COMPANY

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SEVENTH CIRCUIT

PETITION FOR CERTIORARI FILED JUNE 10, 1941
CERTIORARI GRANTED OCTOBER 13, 1941

IN THE

United States Circuit Court of Appeals
For the Seventh Circuit

No. 7458

JOLIET & CHICAGO RAILROAD COMPANY,
Plaintiff-Appellant,

vs.

THE UNITED STATES OF AMERICA,
Defendant-Appellee.

Appeal from the District Court of the United States for the Northern District of Illinois, Eastern Division.

INDEX.

1 Pleas in the District Court of the United States for the Northern District of Illinois, Eastern Division, begun and held at the United States Court Room, in the City of Chicago, in said District and Division, before the Honorable Michael L. Igoe, District Judge of the United States for the Northern District of Illinois, on Thirteenth day of May, in the year of our Lord one thousand nine hundred and Forty, being one of the days of the regular May Term of said Court, begun Monday, the Sixth day of May, and of our Independence the 164th year. Placita.

Present:

Honorable Michael L. Igoe, District Judge.
William H. McDonnell, U. S. Marshal.
Hoyt King, Clerk.

2 IN THE DISTRICT COURT OF THE UNITED STATES,

Northern District of Illinois,

Eastern Division.

Joliet & Chicago Railroad Company, a corporation,
vs.
United States of America. } No. 692.

Be It Remembered, that the above-entitled action was commenced by the filing of the following Bill of Complaint in the above-entitled cause, in the office of the Clerk of the District Court of the United States, for the Northern District of Illinois, Eastern Division, on this the Nineteenth day of June, A. D. 1939.

Filed June 19, 1939. 3 IN THE DISTRICT COURT OF THE UNITED STATES.

* * (Caption—692) * *

BILL OF COMPLINT.

The plaintiff, Joliet & Chicago Railroad Company, a corporation, complains of the defendant, United States of America, and says:

1. The plaintiff is a corporation organized and existing under and by virtue of the laws of the State of Illinois.

2. This action is for the recovery of income taxes in the principal amount of $46,674.33, erroneously and illegally assessed and collected from plaintiff under the Internal Revenue laws of the United States.

3. On January 1, 1864 plaintiff, being then the owner of thirty-seven miles of railroad between the cities of Joliet and Chicago, in the State of Illinois, demised the same, together with all appurtenances thereof, without reservation, unto the Chicago and Alton Railroad Company, its successors and assigns forever, upon the terms and conditions contained and set forth in an indenture executed between the parties on said date (a true and correct copy of said indenture being hereto attached, marked "Exhibit A", and hereby made a part hereof).

4. It is provided in and by said indenture as follows:

4 "And the said party of the second part (said Chicago and Alton Railroad Company) hereby further covenants and agrees, to and with the said party of the first party (the plaintiff herein) that it, the said party of the second part, will guarantee and pay unto the holders of the shares of all the capital stock of the party of the first part, whether new or old, amounting to fifteen thousand shares, an annual dividend of seven per centum upon the par value of said shares of capital stock, and the said party of the second part further covenants and agrees that it will pay said dividend quarterly, in equal installments, on the first Monday in April, July, October and January, hereafter.

"And the said party of the second part hereby further covenants and agrees, to and with the said party of the first part, that for the purpose of paying the dividend hereinbefore agreed to be paid by said party of the second part, upon the capital stock of the party of the first part, it, the said party of the second part, will, on the first day of Febraury, A. D. 1864, and on the first day of each and every month thereafter, deposit in the custody of the United States Trust Company of the city and State of New York, the sum of eight thousand seven hundred and fifty dollars in funds bankable and current in said city of New York. Each and all of which deposits so made shall be placed, by the United States Trust Company, to the credit of the stockholders of the party of the first part, as a fund for the purpose of paying to said stockholders, or to their legal representatives or assigns, the dividends hereinbefore provided to be paid quarterly to them in accordance with the covenants hereinbefore set forth and contained.

"• • •

"And the said party of the second part further covenants and agrees, to and with the said party of the first part, that the said sums of money, to be monthly deposited as aforesaid with the United States Trust Company or other depositary in New York City, shall be free of all Federal taxes which are now or may hereafter be levied by the Government of the United States, upon the payment of dividends declared or made upon the capital stock of incorporated companies, and that the dividend

hereinbefore provided to be paid by the said party of the second part upon the capital stock of the party of the first part, shall be paid in full and without any deduction therefrom for any Federal tax whatsoever upon the payment of said dividend, and that all taxes which may at any time hereafter be due to the United States Government on account of said dividends so paid from time to time, shall be paid by the said party of the second part to the United States Government. Provided, nevertheless, and it is distinctly understood and agreed between the parties hereto, that any and all sums of money which may from time to time be allowed and paid by the depositors hereinbefore mentioned for and on account of interest allowed upon the sums of money deposited with it as aforesaid, shall be the property of and subject to the control and disposal of the said party of the second part."

5. The Alton Railroad Company, an Illinois corporation, as assignee of the purchasers thereof, acquired title on July 18, 1931, to the railroad and properties formerly owned by said The Chicago and Alton Railroad Company, said purchasers having acquired such title pursuant to a sale thereof ordered by this court in proceedings in equity entitled "The Texas Company *vs.* The Chicago and Alton Railroad Company", designated as Cause No. 2940. Said The Alton Railroad Company, as such assignee, entered into possession of said properties July 19, 1931, and has since that time been in possession of and operated the same, including the properties demised by the plaintiff as aforesaid under said indenture of January 1, 1864.

6. The said indenture is in form a perpetual lease and contains no provision or condition upon which the same may be terminated by the plaintiff in the event of the failure on the part of The Chicago and Alton Railroad Company, its successors or assigns, to make payments to the holders of all the plaintiff's capital stock (in accordance with the provisions above set forth), or otherwise to carry out and execute the covenants contained in the said indenture. Plaintiff is advised and believes, and therefore alleges, that the said indenture effectively conveyed title in fee simple absolute to said The Chicago and Alton Railroad Company, its successors and assigns, and that by virtue thereof such title to properties formerly owned by it is now in said The Alton Railroad Company.

6 7. Said The Alton Railroad Company, from the date of its acquisition of said properties as aforesaid and during the subsequent calendar years, 1932, 1933 and 1934, paid to the plaintiff's stockholders amounts equal to annual dividends of $7 per share in quarterly instalments in the manner and on the dates as set forth in the foregoing provisions of said indenture.

8. Proceeding under the erroneous theory that Article 51 of Regulations 77 promulgated by the Secretary of the Treasury of the United States imposed such requirement, plaintiff filed an income tax return for the year 1931 on March 12, 1932, reflecting the amount of dividends paid to plaintiff's stockholders by said The Alton Railroad Company (and its predecessor) as income of the plaintiff for the year 1931 and taxable to it as such. Said The Alton Railroad Company paid for the plaintiff a tax of $12,600, computed on that premise for the year in question. Subsequently, on November 22, 1933, proceeding under the purported authority of Article 130 of said Regulations 77, an additional assessment of $1,512 was proposed by the Internal Revenue Agent in Charge, Baltimore, Maryland, on the theory that the amount of tax so paid for the plaintiff by said The Alton Railroad Company constituted additional taxable income to the plaintiff, and on January 8, 1934 such additional amount of $1,512, together with interest of $160.50, was paid by said The Alton Railroad Company for the plaintiff to J. Enos Ray, the then Collector of Internal Revenue at Baltimore, Maryland.

9. In like manner, for the calendar year 1932, plaintiff filed an income tax return on or about March 14,
7 1933 reflecting the same amount of payments to plaintiff's stockholders as had been shown for the year 1931 as rental income to the plaintiff. The consequent tax amounted to $14,437.50 and was paid for the plaintiff by said The Alton Railroad Company. A proposed deficiency, based on the same grounds as the deficiency of 1931, amounting to $1,985.16, was also proposed by said letter of November 22, 1933, and, together with interest of $91.62, was likewise paid January 8, 1934 to the said J. Enos Ray by said The Alton Railroad Company.

10. For the years 1933 and 1934 the plaintiff filed an income tax return on or before March 15th of the respective succeeding years, reflecting as its income for said calendar years, respectively, the amounts of payments to plaintiff's stockholders and of the income tax imposed

thereon as taxable income of the plaintiff. The resulting tax amounted to $16,422.66 for each of said years, and was paid for the plaintiff by said The Chicago and Alton Railroad Company.

11. Payment of said income taxes in accordance with the returns filed for the years 1932, 1933 and 1934, were made in quarterly instalments. The dates and amounts of such quarterly payments and the several collectors of Internal Revenue at Baltimore, Maryland, to whom they were paid, are as follows:

For the calendar year 1932:

Date:	Amount:	To whom paid:
On or before March 15, 1933	$ 3,609.38	Galen L. Tait
On or before June 15, 1933	3,609.38	Galen L. Tait
On or before Sept. 15, 1933	3,609.38	J. Enos Ray
On or before Dec. 15, 1933	3,609.36	J. Enos Ray
Total	$14,437.50	

For the calendar year 1933:

On or before March 15, 1934	$ 4,105.67	J. Enos Ray
On or before June 15, 1934	4,105.67	J. Enos Ray
On or before Sept. 15, 1934	4,105.67	Lewis H. Melbourne (Acting Collector)
On or before Dec. 15, 1934	4,105.65	Lewis H. Melbourne (Acting Collector)
Total	$16,422.66	

8 For the calendar year 1934:

On or before March 15, 1935	$ 4,105.67	Lewis H. Melbourne (Acting Collector)
On or before June 15, 1935	4,105.67	Lewis H. Melbourne (Acting Collector)
On or before Sept. 15, 1935	4,195.67	Lewis H. Melbourne (Acting Collector)
Total	$12,317.01	

The term of office of said collector, Galen L. Tait, terminated on July 4, 1933, of said collector J. Enos Ray on September 10, 1934, and of said acting collector Lewis H. Melbourne on September 17, 1935.

12. On June 13, 1935 plaintiff filed claims for refund of the additional assessment of $1,512 paid for the year 1931, and for the full amount of the taxes paid for the year 1932 and 1933, in each case with interest thereon, with the Collector of Internal Revenue at Baltimore, Maryland. The same were rejected by letter of the Commissioner of Internal Revenue dated June 21, 1937. Plaintiff also filed on April 27, 1936 a claim for refund of the tax so paid for the year 1934, with interest, with the Collector of Internal Revenue at Baltimore, Maryland. Such claim was rejected by letter of the Commissioner of Internal Revenue dated July 13, 1937.

13. The assessment and collection of the aforesaid amounts of tax aggregating $46,674.33, together with interest on said deficiencies aggregating $252.12, was not warranted under any proper construction of the Revenue Acts of 1928, 1932 and 1934, or of the Regulations promulgated pursuant thereto, since the payments made by The Alton Railroad Company to the plaintiff's stockholders did not constitute rental paid even constructively to the plaintiff, nor income either actual or constructively received by it. Plaintiff, in fact, had no income, actual or constructive, for the years 1931 to 1934, inclusive. Said The Alton Railroad Company operated at a loss during each of said years, and the properties demised by said indenture were also operated at a loss, so that the
9 payments made to plaintiff's stockholders were made by said The Alton Railroad Company solely by reason of the guaranty contained in said indenture and not out of any earnings derived from said demised property.

14. The assessment and collection from plaintiff of the aforesaid amounts aggregating $46,674.33 was contrary to and in violation of the fifth amendment to the Constitution of the United States, in that such assessment and collection deprived plaintiff of property without due process of law, and such assessment and collection were also contrary to and in violation of plaintiff's rights under the statutes of the United States and under the other provisions of the said Constitution.

15. The said income taxes and interest in the aforesaid

amounts aggregating $46,926.45, were erroneously collected from plaintiff, and defendant became and is bound by law to pay to plaintiff in said amount of $46,926.45, with interest at the rate of 6% per annum on said several items thereof, from the dates respectively set forth below to a date not less than thirty days prior to payment thereof:

Amount:	Dates Interest Commences To Run:
$3,609.38	March 15, 1933
3,609.38	June 15, 1933
3,609.38	September 15, 1933
3,609.36	December 15, 1933
1,672.50	January 8, 1934
2,076.78	January 8, 1934
4,105.67	March 15, 1934
4,105.67	June 15, 1934
4,105.67	September 15, 1934
4,105.65	December 15, 1934
4,105.67	March 15, 1935
4,105.67	June 15, 1935
4,105.67	September 15, 1935

16. Defendant, though often requested, has not paid plaintiff the amount so paid by it, or any part thereof, but has altogether refused, and still refuses, to pay the same, or any part thereof.

Wherefore, plaintiff prays judgment for $46,926.45, with interest at the rate of 6% per annum on the various items aggregating said amount, computed as set forth in paragraph 15 above, together with the costs of this action.

Joliet & Chicago Railroad Company,
By Silas H. Strawn,
Frank H. Towner,
Arthur D. Welton, Jr.,
Its Attorneys.

Silas H. Strawn,
Frank H. Towner,
Arthur D. Welton, Jr.,
Attorneys for plaintiff.

11 State of Illinois, } ss.
County of Cook. }

H. L. Stuntz, being first duly sworn, on oath deposes and says that he is Assistant Comptroller of the plaintiff in the foregoing complaint; that he has read the above and foregoing complaint; that he is familiar with the facts therein set forth and that the same are true in substance and in fact, except as to matters alleged to be on information and belief, and as to those matters he believes them to be true.

H. L. Stuntz,

Subscribed and sworn to before me this 19th day of June, 1939.

Rose M. Leoni,
(Seal) *Notary Public.*

12 EXHIBIT A.

Joliet & Chicago Rail Road Company

to

Chicago & Alton Rail Road Company

Lease

This Indenture made and entered into this first day of January, in the year of our Lord One thousand eight hundred and sixty four, by and between The Joliet and Chicago Rail Road Company, the proprietor and owner of thirty seven miles of Rail-Road, between the Cities of Joliet and Chicago, in the state of Illinois, party of the first part, and the Chicago, and Alton Railroad Company, the proprietor and owner of two hundred, and twenty miles between the Cities of Joliet and Alton, in the State of Illinois party of the second part.

Witnesseth; that the said party of the first part, for and in consideration of the rents covenants and agreements, hereinafter contained and set forth, on behalf of the said party of the second part, its successors and assigns, to be paid kept and performed, hath granted demised and leased, and by these presents doth grant demise and lease, unto

the said party of the second part, and its successors and assigns, all and singular the Rail Road, Rail Road Track; Station Houses Water-Stations, Depots, Depots-Grounds, Engine-Houses, and Structures, of every kind whatsoever belonging to the said party of the first part, together with all and singular, the Locomotive Engines and Cars of every description, whatsoever, of which said party of the first part may now be possessed.

To have and to hold, the said above demised and
13 leased premises, together with all the appurtenances thereof without reservation, unto the said party of the second part, and to its successors and assigns from and after the First day of January in the year of our Lord one thousand eight hundred, and sixty four Forever, upon the terms and conditions hereinafter contained and set forth.

And the said party of the second part, for itself its successors and assigns, hereby covenants, and
(5 cts u st) agrees to and with the said party of the first
( ) part, that it, the said party of the second
(stamp) part, will forever, use and operate the said demised and leased premises, as a part of the main line of the Chicago and Alton Railroad.

And the said party of the second part for itself it successors and assigns, hereby further covenants and agrees to and with the said party of the first part, that it the said party of the second part, will at all times hereafter, at its own proper cost and expense, keep in good and sufficient repair, and in good working order, the Rail Road belonging to said party of the first part, together with the Rail Road Track, bridges fences, stations, depots, water tanks, and appurtenances thereof and that it, the said party of the second part, will at its own proper cost maintain the same, in such condition as it, the said party of the second part, shall deem necessary to ensure the efficiency thereof and for the convenient, and speedy dispatch of the ordinary railway, traffic over the same, and that for this purpose, the said party of the second part, will make all needful and proper repairs thereto, including the renewal of the track of said Rail Road, and all repairs and re-
14 newals of every kind whatsoever, which may from time to time be rendered necessary by reason of the wear and tear, of said Rail Road, and its appurtenances, and which may be necessary, to secure the prompt and efficient dispatch of the ordinary business which may at

any time hereafter be transacted upon said Rail Road. And the said party of the first part, as a further consideration to the said party of the second part, for the execution of this Lease, hereby covenants, and agrees, that it, the said party of the first part, on or before the first day of January A. D. 1864 will pay to the said party of the second part, the sum of Five hundred thousand dollars, which said sum of Five hundred thousand dollars may be paid to the said party of the second part, by the delivery to the said party of the second part, on or before the said first day of January A. D. 1864 of Five thousand new shares of the capital stock of the said party of the first part of the par value, of one hundred dollars each, issued by said party of the first part, in accordance with the terms, and provisions of its act of Incorporation.

And the said party of the first part hereby further agrees to and with the said party of the second part, that it, the said party of the first part, will not at any time hereafter make any further issue of its capital stock, then the issue hereinbefore provided to be made, and that the said party of the first part, will not at any time hereafter, execute any Mortgage or trust deed, upon the property herein before demised, and leased to the said party of the second part, and that it the said party of the first part, will not at any time hereafter issue any bonds secured, in any manner by any pledge or mortgage, upon the said demised premises.

And the said party of the second part for the considerations aforesaid, for itself, its successors, and assigns, hereby further, covenants and agrees to and with the said party of the first part, that it, the said party of the second part will assume and pay the annual interest, upon the bonds heretofore issued, by the said party of the first part, and which may be at this time outstanding uncancelled, the said bonds being Five hundred in number, each for the sum of One thousand dollars, bearing interest, payable semi annually, at the rate of eight per centum per annum, at the Continental Bank in New York City, and secured by a deed of trust, executed on the first day of July A. D. 1857 by the party of the first part, to Luther C. Clark. And the said party of the second part hereby further agrees, to and with the said party of the first part, that it, the said party of the second part, will assume and pay the principal of the Bonds of the party of the first part herein-

before specified, when the same shall become due, and payable, and that it, the said party of the second part, will at all times hereafter carefully observe, and keep the conditions and agreements, contained in the trust deed, hereinbefore mentioned, on behalf of the party of the first part, so far as the said conditions, are designed and intended to secure the payment of the principal of interest of said bond. And the said party of the second part, hereby further covenants and agrees, to and with the said party of the first part, that it the said party of the second part, will guarantee and pay, unto the holders of the shares of
16 all the capital stock of the party of the first part, whether new or old, amounting to Fifteen thousand shares, an annual dividend of seven per centum, upon the par value of said shares of capital Stock, and the said party of the second part, further covenants and agrees, that it will pay the said dividend, quarterly in equal installments, on the first Monday in April, July, October and January hereafter. And the said party of the second part hereby further covenants and agrees, to and with the said parties of the first part, that for the purpose of paying the dividend, herein before agreed, to be paid by said party of the second part, upon the capital Stock of the party of the first part, it, the said party of the second part, will on the first day of February A. D. 1864 and on the first day of each and every month hereafter, deposit in the custody of the United States Trust Company of the State of New York, the sum of Eight thousand seven hundred and fifty dollars in funds, bankable and current in said City of New York, each and all of which deposits so made shall be placed by the said United States Trust Company to the Credit of the Stockholders of the party of the first part, as a fund for the purpose of paying to said Stockholders, or to their legal representatives or assigns the dividends herein before, provided to be paid quarterly to them in accordance, with the covenants herein before set forth and contained.

And it is hereby mutually agreed between the parties hereto, that if at any time hereafter the said United States Trust Company shall cease to exist, or shall become an unsafe depository of the funds hereinbefore agreed to be deposited with it, or shall refuse to receive the said
17 deposits, then in either of said cases the Board of Directors of the party of the first part and the Board of

Directors of the party of the second part, acting together, shall select and designate a depository of said funds, and the said funds shall be paid into the depository so selected and designated. And the said party of the second part further covenants and agrees to and with the said party of the first part, that the said sums of money to be monthly deposited as aforesaid, with the United States Trust Company or other depository, in New York City, shall be free of all federal taxes which are now or may hereafter be levied by the Government of the United States, upon the payment of dividends, declared or made upon the capital Stock of incorporated companies, and that the dividend hereinbefore provided to be paid by the said party of the second part upon the capital stock of the party of the first part, shall be paid in full, and without any deduction therefrom for any federal tax whatsoever, upon the payment of said dividend, and that all taxes which may at any time hereafter be due, to the United States Government on account of said dividend so paid from time to time, shall be paid by the said party of the second part to the United States Government. Provided nevertheless, and it is distinctly understood and agreed between the parties hereto, that any and all sums of money which may from time to time, be allowed and paid by the depositary herein before mentioned, for and on account of interest allowed upon the sums of money deposited with it as aforesaid, shall be the property of, and subject to the control and disposal of the said party of the second part.

(5 cts. u.)
(states)
(stamps)

And the said party of the second part for the consideration aforesaid hereby further agrees to and with the said party of the first part, that it, the said party of the second part, will at all times hereafter pay all taxes, whether federal, State, County or municipal, which are or may hereafter, be assessed against the premises hereinbefore demised, and leased at the time, when said taxes may be due and payable.

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And the said party of the second part for the consideration aforesaid, and for the purpose of further securing and guaranteeing, to the said party of the first part, the faithful performance of all and singular the covenants and agreements herein contained, on the part and behalf of the said party of the second part, to be performed and kept, hereby expressly pledges, to the said party of the first

part, thirty seven parts out of two hundred and fifty seven parts of the gross receipts of the line of Rail Road, between the Cities of Alton and Chicago, which is formed by the two lines of Rail Road herein before mentioned. And the said party of the second part, for the purpose of ascertaining the said thirty seven two hundred and fifty sevenths of the Gross Receipts so pledged as aforesaid, and for the purpose of further securing to the party of the first part, the performance of the covenants and agreements herein contained to be performed and kept on the part and behalf of said party of the second part hereby covenants, and agrees, to and with the said first party, that it the said party of the second part will keep a true and accurate account of the gross receipts of the line of rail Road between the Cities of Chicago and Alton, and that it will at the end of each and every month hereafter, and within twenty days thereafter, make up and ex-
19 hibit to the proper officers of the said party of the first part, a true and correct statement of said gross receipts for that month.

And the said party of the second part, hereby further covenants and agrees, to and with the said party of the first part, that at the end of each and every month, in the year, and within twenty days thereafter, it, the said party of the second part, will divide the amount of the gross receipts for that month as shown by the statement, hereinbefore provided for, into two hundred, and fifty seven equal shares, equalling the number of miles of Rail Road to be operated by the said party of the second part under this agreement, and that it, the said party of the second part will cause thirty seven parts of the two hundred and fifty seven parts, so ascertained, to be placed to the Credit of said party of the first part, upon the books of account of the party of the second part, and that these thirty seven equal parts, shall be by said party of the second part specially retained and reserved, as a fund pledged for the purpose of securing and guaranteeing to the said party of the first part the performance of the covenants and agreements herein contained on behalf of the party of the second part, so far as the same shall relate to the maintainance and repair of its Rail Road, and appurtenances the payment of the semi-annual interest, upon the outstanding Bonds of the party of the first part, and the monthly deposit of the sums of money herein before provided to be made by the party of the second part, for the purpose of paying the quarterly dividends, upon the shares

of the Capital stock of the party of the first part. And
20 the said party of the second part further agrees to and with the said party of the first part that in case the amount herein provided, to be placed monthly to the credit of the said party of the first part, upon the books of account of the party of the second part, shall at the end of any month hereafter be insufficient to pay the said party of the first part the full amount herein agreed to be paid or secured by said party of the second part during that month, as also the proportionate part for that month of the quarterly dividend herein agreed to be paid by said party of the second part, and the proportionate part for that month of the semi-annual interest to be paid by said party of the second part, upon the outstanding bonds, of said party of the first part, then and in that case, any deficiency which may so arise, by reason of thirty seven two hundred and fifty seventh of the gross receipts, of the line of Rail Road, between Chicago and Alton being insufficient to secure and cover the monthly proportion of all the payments herein before provided to be paid by the party of the second part, shall be made up and supplied by the further assignment and Credit to the said party of the first part, upon the books of account of said party of the second part of so much of its receipts, in addition to that already assigned and credited as may be necessary to supply the deficiency. And it is hereby mutually agreed between the parties hereto, that the end of each and every six month hereafter or as soon as the same can be reasonably done an account shall be taken, of the amounts paid by said party of the second part, during said six month in accordance with the covenants and agreements herein contained and the amount
21 of said payments shall be ascertained and on account shall also at the same time be taken of the amounts credited at the end of each and every month, during said sixth month to the party of the first part in accordance with the provisions hereof, and the amount of said Credits shall be computed and ascertained, and if at the time of making said computations, it shall be found that the amount of the credits, so made during said six month, shall exceed the amount of the payments made or to be made, by said party of the second part, during said period of sixth month, then the excess so ascertained, shall be restored to the said party of the second part, upon its books of account, the proper entries being made therein for that purpose and as to said

excess the lien of the party of the first part upon the same herein before provided for, shall be satisfied and discharged. And the said party of the second part hereby further covenants and agrees to and with said party of the first part that the said party of the first part for the purpose of verifying the accounts herein provided to be rendered by said party of the second part shall at all proper times by its president or any person appointed by him for that purpose, have access to the books of account and vouchers of the said party of the second part. And the said party of the second part hereby further covenants, and agrees, to and with the, said party of the first part, that it, the said party of the second part, will at all times hereafter guarantee and indemnify the said party of the first part, against all claims for damage growing out of the operation of the said line of Rail Road between the Cities of Chicago and Alton, and that it the said party of the second part, will pay and
22 satisfy all damages, which may be assessed against either of the parties hereto, growing out of the operation of said line of Rail Road, whether the same be founded upon claims for non performance of duty as common carriers of passengers or freight, injuries to cattle or other animals, along the line of said Rail Road losses arising from fires communicated along said line of Rail Road from the locomotive engines used thereon, or from any other cause occurring hereafter by the negligence or dereliction of duty of the party of the second part in the conduct of the business and traffic of said line of railroad. And the said party of the second part, hereby agrees to and with the said party of the first part, that it the said party of the second part, will hereafter pay the salaries of the following officers, of the parties of the first part, namely; The President of the said Joliet and Chicago Rail Road Company the secretary thereof, and the transfer Agent of said Company in New York City, provided that the aggregate amount of the annual salaries of said officers shall not exceed the sum of two thousand dollars, and that it the said party of the second part, will also pay to the United States Trust Company or other depository in the City of New York, the annual charge made by such depository for the registration of the shares of the capital stock of the said party of the first part, and the payment of the quarterly dividends thereon, hereinbefore provided to be paid. And it is mutually agreed between the parties hereto, that if at any time hereafter, any

disagreement shall arise between the parties
(stamp) hereto as to the construction of any of the
(5 cts. u.st) articles of this agreement, and which said disagreement, cannot be adjusted and settled between, the respective officers of the two corporations,
23 parties hereto, or in any case any question should hereafter arise between the parties hereto, as to the nonfulfillment of any of the agreements, and covenants herein contained, then in all such cases the questions, so arising, shall be submitted to the arbitration of two disinterested persons, skilled in the business of conducting and managing Rail Roads, one of whom shall be chosen by each of the parties hereto, and the said arbitrators so chosen shall have authority and power to make a final decision, and adjustment of such questions and their decision when so made shall be final, and conclusive of the matters and things so determined. And it is further mutually agreed, between the parties hereto, that in case the arbitrators so chosen as aforesaid shall fail to agree upon the adjustment of the question or questions so submitted to them as aforesaid then in such case the two arbitrators, shall choose an umpire, who shall be a disinterested person, skilled in the conduct of Rail Roads, and the award of the umpire so chosen, when made, shall be conclusive as to the questions decided by him.

And it is further mutually agreed, between the parties hereto, that in case the arbitrators chosen, by the parties hereto as aforesaid, shall within ten days, after any disagreement upon a question submitted to them in pursuance, of this agreement, fail to select an umpire as herein provided, then and in that case each of the parties, hereto shall name a person, and from the two persons so named, an umpire shall be selected by drawing lots, who shall have like powers and authority, and whose decision shall be equally binding upon the parties hereto, as though he had been selected by the arbitrators, in the manner herein
24 provided for. And it further mutually agreed, between the parties hereto, that if at any time either of said parties, after ten days notice in writing so to do, shall fail to name an umpire to be selected by lot, in the manner herein before provided for, then and in that case, the person selected by the other party shall be authorized and empowered to act as umpire and his decision of the question submitted to him, shall be final and conclusive between the parties hereto.

(Seal) (Corporate) (Seal) (Corporate) In Witness whereof the parties have caused these presents to be sealed with their respective corporate Seals and to be signed by their respective presidents and Secretaries on this first day of January, in the year of our Lord one thousand eight hundred and sixty four.

Joseph Price,
Secretary of the Joliet & Chicago Rail Road Company.

Joseph Price,
Secretary of the Chicago and Alton Railroad Company.

The words "of the party of the first part" on page two line 30, and the words "hereby covenants and agrees, to and with the said first party that it, the said party of the second part" on page 3 line 34 and the words "and the proportionate part for that month of the semi-annual interest, to be paid by said party of the second part" on page 4, line 13, and the word "so" on page 4, line 14, and word hereafter, on page 4, line 22, interlined in this agreement before signing the same. The word three on page one (1) line three (3) was altered to fore in this agreement, before signing the same.

T. B. B. *Prest.*

T. B. Blackstone,
Prest., Joliet & Chicago Rd. Co.

Sam Robb,
President of the Chicago & A. R. R. Co.

25 And on, to wit, the 19th day of June, 1939, came the Joliet & Chicago Railroad Company, Plaintiff, by its attorneys and filed in the Clerk's office of said Court its certain Complaint in the case of Joliet & Chicago Railroad Company *vs.* United States of America, No. 693, in words and figures following, to wit:

26 IN THE DISTRICT COURT OF THE UNITED STATES. Filed June 19, 1939.
* * (Caption—693) * *

BILL OF COMPLAINT.

The plaintiff, Joliet & Chicago Railroad Company, a corporation, complains of the defendant, United States of America, and says:

1. The plaintiff is a corporation organized and existing under and by virtue of the laws of the State of Illinois.

2. This action is for the recovery of income taxes in the principal amount of $4,105.65, erroneously and illegally assessed and collected from plaintiff under the Internal Revenue laws of the United States.

3. On January 1, 1864 plaintiff, being then the owner of thirty-seven miles of railroad between the cities of Joliet and Chicago, in the State of Illinois, demised the same, together with all the appurtenances thereof, without reservation, unto the Chicago and Alton Railroad Company, its successors and assigns forever, upon the terms and conditions contained and set forth in an indenture executed between the parties on said date (a true and correct copy of said indenture being hereto attached, marked "Exhibit A", and hereby made a part hereof).

4. It is provided in and by said indenture as follows:

27 "And the said party of the second part (said Chicago and Alton Railroad Company) hereby further covenants and agrees, to and with the said party of the first part (the plaintiff herein) that is, the said party of the second part, will guarantee and pay unto the holders of the shares of all the capital stock of the party of the first part, whether new or old, amounting to fifteen thousand shares, an annual dividend of seven per centum upon the par value of said shares of capital stock, and the said party of the second part further covenants and agrees that it will pay said dividend quarterly, in equal installments, on the first Monday in April, July, October and January, hereafter.

"And the said party of the second part hereby further covenants and agrees, to and with the said party of the first part, that for the purpose of paying the dividend hereinbefore agreed to be paid by said party of the second part, upon the capital stock of the party of the first part, it, the

said party of the second part, will, on the first day of February, A. D. 1864, and on the first day of each and every month thereafter, deposit in the custody of the United States Trust Company of the city and State of New York, the sum of eight thousand seven hundred and fifty dollars in funds bankable and current in said city of New York. Each and all of which deposits so made shall be placed, by the United States Trust Company, to the credit of the stockholders of the party of the first part, as a fund for the purpose of paying to said stockholders, or to their legal representatives or assigns, the dividends hereinbefore provided to be paid quarterly to them in accordance with the covenants hereinbefore set forth and contained.

" * * * * * *

"And the said party of the second part further covenants and agrees, to and with the said party of the first part, that the said sums of money, to be monthly deposited as aforesaid with the United States Trust Company or other depository in New York City, shall be free of all Federal taxes which are now or may hereafter be levied by the Government of the United States, upon the payment of dividends declared or made upon the capital stock of incorporated companies, and that the dividend hereinbefore provided to be paid by the said party of the second part upon the capital stock of the party of the first part, shall be paid in full and without any deduction therefrom for any Federal tax whatsoever upon the payment of said dividend, and that all taxes which may at any time hereafter be due to the United States Government on account of said dividends so paid from time to time, shall be paid by the said party of the second part to the United States Govern-
28 ment. Provided, nevertheless, and it is distinctly understood and agreed between the parties hereto, that any and all sums of money which may from time to time be allowed and paid by the depository hereinbefore mentioned for and on account of interest allowed upon the sums of money deposited with it as aforesaid, shall be the property of and subject to the control and disposal of the said party of the second part."

5. The Alton Railroad Company, an Illinois corporation, as assignee of the purchasers thereof, acquired title on July 18, 1931, to the railroad and properties formerly owned by said The Chicago and Alton Railroad Company, said purchasers having acquired such title pursuant to a sale thereof ordered by this court in proceedings in equity en-

titled "The Texas Company *vs.* The Chicago and Alton Railroad Company", designated as Cause No. 2940. Said The Alton Railroad Company, as such assignee, entered into possession of said properties July 19, 1931, and has since that time been in possession of and operated the same, including the properties demised by the plaintiff as aforesaid under said indenture of January 1, 1864.

6. The said indenture is in form a perpetual lease and contains no provision or condition upon which the same may be terminated by the plaintiff in the event of the failure on the part of The Chicago and Alton Railroad Company, its successors or assigns, to make payments to the holders of all the plaintiff's capital stock (in accordance with the provisions above set forth), or otherwise to carry out and execute the covenants contained in the said indenture. Plaintiff is advised and believes, and therefore alleges, that the said indenture effectively conveyed title in fee simple absolute to said The Chicago and Alton Railroad Company, its successors and assigns, and that by virtue thereof such title to properties formerly owned by it is now in said The Alton Railroad Company.

29 7. Said The Alton Railroad Company, from the date of its acquisition of said properties as aforesaid and during subsequent calendar years, including the year 1934, paid to the plaintiff's stockholders amounts equal to annual dividends of $7 per share in quarterly instalments in the manner and on the dates as set forth in the foregoing provisions of said indenture.

8. For the year 1934 the plaintiff filed an income tax return on or about March 14, 1935, reflecting as its income for such year the amounts of payments to plaintiff's stockholders and of the income tax imposed thereon as taxable income of the plaintiff. The resulting tax amounted to $16,422.66 for such year, and was paid in quarterly instalments by said The Chicago and Alton Railroad Company. The final instalment, amounting to $4,105.65, was paid to M. Hampton Magruder, then and now Collector of Internal Revenue at Baltimore, Maryland.

9. Plaintiff filed on April 27, 1936 a claim for refund of the tax so paid for the year 1934, with interest, with the Collector of Internal Revenue at Baltimore, Maryland. Such claim was rejected by letter of the Commissioner of Internal Revenue dated July 13, 1937.

10. The assessment and collection of the aforesaid tax of $4,105.65 was not warranted under any proper construc-

tion of the Revenue Act of 1934, or of the Regulations promulgated pursuant thereto, since the payments made by The Alton Railroad Company to the plaintiff's stockholders did not constitute rental paid even constructively to the plaintiff, nor income either actually or constructively received by it. Plaintiff, in fact, had no income, actual or constructive, for the year 1934. Said The Alton Railroad Company operated at a loss during the year 1934, and the properties demised by said indenture were also operated at a loss, so that the payments made to plaintiff's stockholders during that year were made by said The Alton Railroad Company solely by reason of the guarantee contained in said indenture and not out of net earnings derived from said demised property.

11. The assessment and collection from plaintiff of the aforesaid amount of $4,105.65 was contrary to and in violation of the fifth amendment to the Constitution of the United States, in that such assessment and collection deprived plaintiff of property without due process of law, and such assessment and collection were also contrary to and in violation of plaintiff's rights under the statutes of the United States and under the other provisions of the said Constitution.

12. The said income taxes in the amount of $4,105.65 were erroneously collected from plaintiff, and defendant became and is bound by law to pay to plaintiff in said amount of $4,105.65, with interest at the rate of 6% per annum on said item, from December 15, 1935 to a date not less than thirty days prior to payment thereof.

13. Defendant, though often requested, has not paid plaintiff the amount so paid by it, or any part thereof, but has altogether refused, and still refuses, to pay the same, or any part thereof.

Wherefore, plaintiff prays judgment for $4,105.65, with interest thereon at the rate of 6% per annum, computed as set forth in paragraph 12 above, together with the costs of this action.

Joliet & Chicago Railroad Company,
By Silas H. Strawn,
Frank H. Towner,
Arthur D. Welton, Jr.,
Its Attorneys.

Silas H. Strawn,
Frank H. Towner,
Arthur D. Welton, Jr.,
Attorneys for Plaintiff.

31 State of Illinois, } ss.
County of Cook. }

H. L. Stuntz, being first duly sworn, on oath deposes and says that he is Assistant Comptroller of the plaintiff in the foregoing complaint; that he has read the above and foregoing complaint; that he is familiar with the facts therein set forth, and that the same are true in substance and in fact, except as to matters alleged to be on information and belief, and as to those matters he believes them to be true.

H. L. Stuntz.

Subscribed and sworn to before me this 19th day of June, 1939.

Rose W. Levin,
(Seal) *Notary Public.*

(Exhibit "A" hereto follows. Not copied.)

32 And on, to wit, the 23rd day of September, 1939, came the Defendant in case No. 692 by its attorneys and filed in the Clerk's office of said Court its certain Answer in words and figures following, to wit: Filed Sept. 23 1939.

33 In the District Court of the United States.
* * (Caption—692) * *

ANSWER.

Comes now the defendant, United States of America, by its attorney, William J. Campbell, United States Attorney for the Northern District of Illinois, and in answer to the complaint herein filed admits, denies, and alleges as follows:

I.

Defendant admits the allegations of paragraph 1 of the complaint.

II.

Defendant admits the allegations of paragraph 2 of the complaint, except that the taxes sought to be recovered were erroneously and illegally assessed and collected.

III.

Answering paragraph 3 of the complaint, defendant admits that plaintiff was the owner of the railroad between Joliet and Chicago, Illinois, and that plaintiff entered into the agreement, a copy of which is marked "Exhibit A" and attached to the complaint. Defendant denies each and every other allegation contained in said paragraph.

IV.

Defendant admits the allegations of paragraph 4 of the complaint.

34

V.

Defendant does not have sufficient information to form an opinion as to the truth of the allegations of paragraph 5 of the complaint and therefore denies the same.

VI.

Defendant denies each and every allegation contained in paragraph 6 of the complaint.

VII.

Defendant admits the allegations contained in paragraph 7 of the complaint.

VIII.

Defendant admits that the Alton Railroad Company originally paid for the plaintiff an income tax of $12,600 for the year 1931 and an additional assessment of $15.12 which was assessed by the Commissioner on November 22, 1933, but denies each and every other allegation contained in paragraph 8 of the complaint.

IX.

Defendant admits the allegations contained in paragraphs 9, 10, 11 and 12 of the complaint.

X.

Defendant denies the allegations contained in paragraphs 13, 14 and 15 of the complaint.

XI.

Defendant admits the allegations contained in paragraph 16 of the complaint.

Wherefore, defendant denies that it is indebted to plaintiff in any amount or that plaintiff is entitled to judgment or any other relief prayed for.

35 As a further defense to said complaint, defendant alleges as follows:

I.

That the first installment of income taxes in the amount of $3,609.38 for the year 1932 was paid on March 15, 1933.

II.

That no claim for refund of the amount of taxes paid for the year 1932 was filed by the plaintiff prior to June 13, 1935.

III.

That Section 322 (b) of the Revenue Act of 1932, c. 209, 47 Stat. 169, provides as follows:

(b) Limitation of Allowance—

(1) Period of Limitation. No such credit or refund shall be allowed or made after two years from the time the tax was paid, unless before the expiration of such period a claim therefor is filed by the taxpayer.

(2) Limit on Amount of Credit or Refund. The amount of the credit or refund shall not exceed the portion of the tax paid during the two years immediately preceding the filing of the claim, or if no claim was filed, then during the two years immediately preceding the allowance of the credit or refund.

IV.

That by virtue of the above provision the first installment of income taxes in the amount of $3,609.38 for the year 1932, which was paid on March 15, 1933, cannot be refunded to the plaintiff as no claim for refund was filed within time.

William J. Campbell,
United States Attorney.

36 State of Illinois, } ss.
County of Cook. }

William J. Campbell, being first duly sworn, on oath deposes and says that he is a duly appointed and qualified United States District Attorney for the Northern District of Illinois, and that in such capacity he is one of the duly authorized representatives of the defendant herein; that he has read the foregoing answer and is familiar with the contents therein, and that the matters and things therein contained are true in substance and in fact.

William J. Campbell.

Subscribed and sworn to before me this 23rd day of September, A. D. 1939.

Anna L. Minahan,
(Seal) *Notary Public.*

State of Illinois, } ss.
County of Cook. }

Anna L. Minahan, being first duly sworn, on oath deposes and says that she is employed as Clerk in the office of the United States Attorney at Chicago, Illinois; that on September 23, 1939 she placed a copy of the above and foregoing answer in a Government franked envelope addressed to Winston, Strawn and Shaw, First National Bank Building, Chicago, Illinois, and deposited said envelope so addressed, and contained said copy of the foregoing Answer, in the United States Mail Chute, Chicago, Illinois.

Anna L. Minahan.

Subscribed and sworn to before me this 23rd day of September, A. D. 1939.

Charles A. Sistek,
(Seal) *Notary Public.*

37 And on, to wit, the 23rd day of September, 1939, came the Defendant in Case No. 693 by its attorneys and filed in the Clerk's office of said Court its certain Answer in words and figures following, to wit:

38 IN THE DISTRICT COURT OF THE UNITED STATES. Filed Sept. 2 1939.
• • (Caption—693) • •

ANSWER.

Comes now the defendant, United States of America, by its attorney, William J. Campbell, United States Attorney for the Northern District of Illinois, and in answer to the complaint herein filed admits, denies, and alleges as follows:

I.

Defendant admits the allegations of paragraph 1 of the complaint.

II.

Defendant admits the allegations of paragraph 2 of the complaint, except that the taxes sought to be recovered were erroneously and illegally assessed and collected.

III.

Answering paragraph 3 of the complaint, defendant admits that plaintiff was the owner of the railroad between Joliet and Chicago, Illinois, and that plaintiff entered into the agreement, a copy of which is marked "Exhibit A" and attached to the complaint. Defendant denies each and every other allegation contained in said paragraph.

IV.

Defendant admits the allegations of paragraph 4 of
39 the complaint.

V.

Defendant does not have sufficient information to form an opinion as to the truth of the allegations of paragraph 5 of the complaint and therefore denies the same.

VI.

Defendant denies each and every allegation contained in paragraph 6 of the complaint.

VII.

Defendant admits the allegations contained in paragraphs 7, 8 and 9 of the complaint.

VIII.

Defendant denies each and every allegation contained in paragraphs 10, 11 and 12 of the complaint.

IX.

Defendant admits the allegations contained in paragraph 13 of the complaint.

Wherefore, defendant denies that it is indebted to plaintiff in any amount or that plaintiff is entitled to judgment or any other relief prayed for.

William J. Campbell,
United States Attorney.

State of Illinois, }
County of Cook. } ss.

William J. Campbell, being first duly sworn, on oath deposes and says that he is a duly appointed and qualified United States District Attorney for the Northern District of Illinois, and that in such capacity he is one of the duly authorized representatives of the defendant herein; that he has read the foregoing Answer and is familiar with the contents thereof, and that the matters and things therein contained are true in substance and in fact.

William J. Campbell.

Subscribed and sworn to before me this 23rd day of September, A. D. 1939.

Anna L. Minahan,
Notary Public.

(Seal)

State of Illinois, }
County of Cook. } ss.

Anna L. Minahan, being first duly sworn, on oath deposes and says that she is employed as Clerk in the office of the United States Attorney at Chicago, Illinois; that on September 22nd, 1938, she placed a copy of the above and foregoing Answer in a Government franked envelop addressed to Winston, Strawn and Shaw, First National Bank Building, Chicago, Illinois, and deposited said envelop so addressed and containing said copy of the foregoing Answer, in the United States Mail Chute located on the 8th floor of the United States Courthouse, Chicago, Illinois.

Anna L. Minahan.

Subscribed and sworn to before me this 23rd day of September, A. D. 1939.

Charles A. Sistek,
Notary Public.

(Seal)

41 And afterwards, to wit, on the 1st day of March, A. D. 1940, being one of the days of the regular February term of said Court, in the record of proceedings thereof, in said entitled cause, before the Honorable Michael L. Igoe, District Judge, appears the following entry, to wit:

Entered Mar. 1, 1940.

42 IN THE DISTRICT COURT OF THE UNITED STATES,

Northern District of Illinois,

Eastern Division.

Joliet & Chicago Railroad Company, *Plaintiff,*
vs.
United States of America, *Defendant.*
} Civil Action No. 692.

Joliet & Chicago Railroad Company, *Plaintiff,*
vs.
United States of America, *Defendant.*
} Civil Action No. 693.

ORDER.

On stipulation of the parties hereto, herein filed by their respective attorneys, it is

Ordered that the above entitled cases be and they hereby are consolidated and shall be tried as one case.

Enter:

Igoe,
Judge.

Dated: March 1, 1940.

Filed Mar. 1, 1940.

43 And on, to wit, the 1st day of March, 1940, came the parties by their attorneys and filed in the Clerk's office of said Court their certain Stipulation of Facts in words and figures following, to wit:

44 IN THE DISTRICT COURT OF THE UNITED STATES.

* * (Captions—692-693) * *

STIPULATION OF FACTS.

It Is Hereby Stipulated, by and between the parties hereto, that the following facts may be taken as true to the same extent as if proved at trial, provided that nothing herein shall prevent either party from objecting to the

materiality of the facts herein stipulated or from introducing further evidence at the trial not inconsistent with the facts herein stipulated.

1. These are actions for the recovery of income taxes paid for the plaintiff for the years 1931 to 1934, inclusive.

2. The plaintiff, Joliet and Chicago Railroad Company, is a corporation organized and existing under and by virtue of the laws of the State of Illinois.

3. On January 1, 1864 the plaintiff, being then the owner of thirty-seven miles of railroad between the cities of Joliet and Chicago, in the State of Illinois, entered into an indenture with the Chicago and Alton Railroad Company under which it demised and leased the same, together with all of the appurtenances thereof, unto said The Chicago and Alton Railroad Company, its successors and assigns, upon the terms and conditions contained and set
45 forth in said indenture, a true and correct copy of said indenture is hereto attached, marked "Exhibit A", and hereby made a part hereof. Among other things said indenture provides:

"And the said party of the second part (said The Chicago and Alton Railroad Company) hereby further covenants and agrees, to and with the said party of the first part (the plaintiff herein) that it, the said party of the second part, will guarantee and pay unto the holders of the shares of all the capital stock of the party of the first part, whether new or old, amounting to fifteen thousand shares, an annual dividend of seven per centum upon the par value of said shares of capital stock, and the said party of the second part further covenants and agrees that it will pay said dividend quarterly, in equal installments, on the first Monday in April, July, October and January, hereafter."

4. The certificates of capital stock of the plaintiff contain the following provision on the face thereof:

"This Stock is limited to 15,000 Shares of One Hundred Dollars each and is issued in accordance with the 2nd Section of the Charter of this Company; it is perpetually guaranteed a Dividend of Seven per cent for each calendar year free of Government tax, payable quarter-annually on the 1st Monday in April, July, Oct. and Jany. th payment of which is secured by a Contract of Lease with the Chicago and Alton Railroad Company of the Railroad of this Company dated 1st January, 1864, the conditions of which are irrevocable and require a deposit monthly with the

United States Trust Company in the City of New York of $8,750, on account of said Dividend, and for the security of the punctual payment monthly of the above sum, 37 parts out of 257 parts of the gross receipts of the Chicago and Alton Railroad Company from the line of railroad between the Cities of Alton and Chicago, are perpetually pledged".

5. The Alton Railroad Company, an Illinois corporation (hereinafter referred to as "the Alton Company") acquired title on July 18, 1931 to the railroad and properties formerly owned by said The Chicago and Alton Railroad Company, including the interest in the said thirty-seven miles of railroad, created by said indenture of January 1, 1864. Such title was secured as assignee of the purchasers of said properties, said purchasers having acquired the same pursuant to a sale thereof ordered by this court in proceedings in equity entitled "The Texas Company *vs.*
The Chicago and Alton Railroad Company", desig-
46 nated as Cause No. 2040. Said The Alton Railroad
Company, as such assignee, entered into possession of said properties July 19, 1931, and since that time has been in possession of and operated the same, including the said thirty-seven miles of railroad between Joliet and Chicago, Illinois.

6. The Alton Company, from the date of its acquisition in 1931 of said properties as aforesaid (and prior thereto its predecessor) paid to the plaintiff's stockholders during the calendar years 1931, 1932, 1933 and 1934 amounts equal to annual dividends of $7 per share ($105.000) in quarterly installments in the manner and on the dates as set forth in the said indenture of January 1, 1864. No resolutions declaring such dividends were adopted by plaintiff's Board of Directors during such years.

7. The plaintiff filed its income tax return for the year 1931 on March 12, 1932, reporting as its income for that year the sum of $105,000, being the amount of dividends for that year paid to its stockholders by the Alton Company (and its predecessor). The resulting tax, amounting to $12,600 was paid by the Alton Company during the year 1932. On November 22, 1933 an additional assessment of $1512 was proposed by the Internal Revenue Agent in Charge at Baltimore, Maryland, on the theory that the amount of tax so paid for the plaintiff by the Alton Company constituted additional taxable income to the plaintiff, and on January 8, 1934 such additional tax of $1512, to-

gether with interest of $160.50 (said amounts having been assessed by the Commissioner of Internal Revenue December 22, 1933) was paid by the Alton Company for the plaintiff to J. Enos Ray, the then Collector of Internal Revenue at Baltimore, Maryland.

8. In like manner for the calendar year 1932 the plaintiff filed an income tax return on or about March 14, 1933, reporting as its taxable income for the year 1932 the
47 sum of $105,000, being the amount of dividends in that year paid to its stockholders by the Alton Company. The resulting tax of $14,437.50 was paid for the plaintiff by the Alton Company. An additional assessment of $1985.16 for the year 1932, based on the same grounds as the deficiency proposed for the year 1931, was also asserted by said letter of November 22, 1933, and together with interest at $91.62 (said amounts having been assessed by the Commissioner of Internal Revenue December 22, 1933) was likewise paid January 8, 1934 to the said J. Enos Ray by the Alton Company.

9. For the years 1933 and 1934 the plaintiff filed an income tax return on or before March 15th of the respective succeeding years reporting as its income for such years the amounts of payments to plaintiff's stockholders, and of the income tax imposed thereon. The resulting tax amounted to $16,422.66 for each of said years and was paid for the plaintiff by the Alton Company. All the payments, except of the said additional assessments, were made in quarterly installments. All of said amounts were assessed by the Commissioner of Internal Revenue. The dates and amounts of such quarterly payments, the dates the assessments were made, and the several Collectors of Internal Revenue at Baltimore, Maryland. to whom they were paid, are as follows:

Year:	Date Assessed:	Amount:	Date Paid:	Amount:	To whom paid:
1932	Apr. 1933	$14,437.50	3/15/33	$3,609.38	Galen L. Tait
			6/15/33	3,609.38	Galen L. Tait
			9/15/33	3,609.38	J. Enos Ray
			12/15/33	3,609.36	J. Enos Ray
1933	Apr. 1934	$16,422.66	3/15/34	4,105.67	J. Enos Ray
			6/15/34	4,105.67	J. Enos Ray
			9/15/34	4,105.67	Lewis H. Melbourne, Acting Collector
			12/15/34	4,105.65	Lewis H. Melbourne, Acting Collector
48 1934	Apr. 1935	$16,422.66	3/15/35	$4,105.67	Lewis H. Melbourne
			6/15/35	4,105.67	" " "
			9/14/35	4,105.67	" " " Acting Collector
			12/16/35	4,105.65	M. Hampton Magruder

The term of office of said Collector Galen L. Tait terminated on July 4, 1933; of said Collector J. Enos Ray on September 10, 1934, and of said Acting Collector Louis H. Melbourne on September 17, 1935. The said Collector, M. Hampton Magruder, was the Collector of Internal Revenue on the date of the filing of the bill of complaint herein.

10. On June 13, 1935 plaintiff filed claims for refund of the additional assessment of $1512 paid for the year 1931, and for the full amount of the taxes paid for the years 1932 and 1933, in each case with interest thereon, with the Collector of Internal Revenue at Baltimore, Maryland. The same were rejected by registered letter of the Commissioner of Internal Revenue dated June 21, 1937. Plaintiff also filed on April 27, 1936 a claim for refund of the tax so paid for the year 1934, with interest, with the Collector of Internal Revenue at Baltimore, Maryland. Such claim was rejected by registered letter of the Commissioner of Internal Revenue dated July 13, 1937. A copy of the said claim for refund for the year 1932 is hereto attached as Exhibit B, and hereby made a part hereof. Each of the other claims is substantially identical to said Exhibit B in form, and is based on the same ground.

11. During the years in question the books of the plaintiff, as well as those of the Alton Company and its predecessor, were maintained pursuant to the classification of accounts for steam roads prescribed by the Interstate Commerce Commission, in accordance with Section 20 of the Act to Regulate Commerce. Such classification requires plaintiff to maintain an account designated "Income from lease of road", and during the years in
49 question this account reflected the amount of the dividends paid by the Alton Company and its predecessor to the plaintiff's stockholders as such income, and during the years 1933 and 1934 this account also reflected the amount of income taxes thereon. Correspondingly, such classification required the Alton Company and its predecessor to maintain an account designated "Rent for leased roads", and the payments of such dividends and all the income taxes thereon assessed against plaintiff were reflected in such account. In the income tax returns filed by the Alton Company deductions were taken for the amounts paid to the plaintiff's stockholders.

12. The Alton Company has operated at a loss since its acquisition in 1931 of the railroad and properties of the

Chicago and Alton Railroad Company. Its net losses have been as follows:

1931 (July 19-December 31)	$ 595,893.34
1932	1,259,704.59
1933	43,251.31
1934	1,644,579.23
Total—	$3,543,428.47

The defendant, while agreeing that the above statement in this paragraph is true, makes such agreement for the purposes of this case only, and objects to the admissibility of the same upon the ground that it is immaterial to this cause.

Frank H. Towner,
Edward G. Ince,
Arthur D. Welton, Jr.,
Attorneys for Plaintiff.

William J. Campbell,
O. K. C. J. M.
United States Attorney.

March 1, 1940.

("Exhibit A" here follows—not copied.)

50 And afterwards, to wit, on the 13th day of May, A. D. 1940, being one of the days of the regular May term of said Court, in the record of proceedings thereof, in said entitled cause, before the Honorable Michael L. Igoe, District Judge, appears the following entry, to wit: Findings of Fact and Conclusions of Law: Filed May 13, 1940.

51 In the District Court of the United States.

* * (Captions—692-693) * *

FINDINGS OF FACT AND CONCLUSIONS OF LAW.

These causes, having been consolidated by stipulation of the parties, were tried together on March 1, 1940, before this Court. All the facts were stipulated. The Court, having heard the arguments of counsel and being fully advised in the premises, now declares and enters the following findings of fact and conclusions of law:

Findings of Fact.

I.

These are actions for the recovery of income taxes paid for the plaintiff for the years 1931 to 1934, inclusive.

II.

The plaintiff, Joliet and Chicago Railroad Company, is a corporation organized and existing under and by virtue of the laws of the State of Illinois.

III.

On January 1, 1864, the plaintiff, being then the owner of thirty-seven miles of railroad between the cities of Joliet and Chicago, in the State of Illinois, entered into an indenture with the Chicago and Alton Railroad
52 Company under which it demised and leased the same, together with all of the appurtenances thereof, unto said The Chicago and Alton Railroad Company, its successors and assigns, upon the terms and conditions contained and set forth in said indenture, a copy of which was attached to the stipulation of facts and marked "Exhibit A". Among other things said indenture provides:

And the said party of the second part (said The Chicago and Alton Railroad Company) hereby further covenants and agrees, to and with the said party of the first part (the plaintiff herein) that it, the said party of the second part, will guarantee and pay unto the holders of the shares of all the capital stock of the party of the first part, whether new or old, amounting to fifteen thousand shares, an annual dividend of seven per centum upon the par value of said shares of capital stock, and the said party of the second part further covenants and agrees that it will pay said dividend quarterly, in equal installments, on the first Monday in April, July, October and January, hereafter.

IV.

The certificates of capital stock of the plaintiff contain the following provision on the face thereof:

This Stock is limited to 15,000 Shares of One Hundred Dollars each and is issued in accordance with the 2nd

Section of the Charter of this Company; it is perpetually guaranteed a Dividend of Seven per cent for each calendar year free of Government tax, payable quarter-annually on the 1st Monday in April, July, Oct. and Jany. the payment of which is secured by a Contract of Lease with the Chicago and Alton Railroad Company of the Railroad of this Company dated 1st January, 1864, the conditions of which are irrevocable and require a deposit monthly with the United States Trust Company in the City of New York of $8,750, on account of said Dividend, and for the security of the punctual payment monthly of the above sum, 37 parts out of 257 parts of the gross receipts of the Chicago and Alton Railroad Company from the line of railroad between the Cities of Alton and Chicago, are perpetually pledged.

53

V.

The Alton Railroad Company, an Illinois corporation (hereinafter referred to as "the Alton Company") acquired title on July 18, 1931, to the railroad and properties formerly owned by said The Chicago and Alton Railroad Company, including the interest in the said thirty-seven miles of railroad, created by said indenture of January 1, 1864. Such title was acquired as assignee of the purchasers of said properties, said purchasers having acquired the same pursuant to a sale thereof ordered by this Court in proceedings in equity entitled "The Texas Company *vs.* The Chicago and Alton Railroad Company", designated as Cause No. 2940. Said The Alton Railroad Company, as such assignee, entered into possession of said properties July 19, 1931, and since that time has been in possession of and operated the same, including the said thirty-seven miles of railroad between Joliet and Chicago, Illinois.

VI.

The Alton Company, from the date of its acquisition in 1931 of said properties as aforesaid (and prior thereto its predecessor) paid to the plaintiff's stockholders during the calendar years 1931, 1932, 1933 and 1934 amounts equal to annual dividends of $7 per share ($105,000) in quarterly installments in the manner and on the dates as set forth in the said indenture of January 1, 1864. No resolutions declaring such dividends were adopted by plaintiff's board of directors during said years.

VII.

The plaintiff filed its income tax return for the year 1931 on March 12, 1932, reporting as its income for that year the sum of $105,000, being the amount of dividends for
54 that year paid to its stockholders by the Alton Company (and its predecessor). The resulting tax, amounting to $12,600 was paid by the Alton Company during the year 1932. On November 22, 1933, an additional assessment of $1,512 was proposed by the Internal Revenue Agent in Charge at Baltimore, Maryland, on the theory that the amount of tax so paid for the plaintiff by the Alton Company constituted additional taxable income to the plaintiff, and on January 8, 1934, such additional tax of $1,512, together with interest of $160.50 (said amounts having been assessed by the Commissioner of Internal Revenue on December 22, 1933) was paid by the Alton Company for the plaintiff to J. Enos Ray, the then Collector of Internal Revenue at Baltimore, Maryland.

VIII.

In like manner for the calendar year 1932 the plaintiff filed an income tax return on or about March 14, 1933, reporting as its taxable income for the year 1932 the sum of $105,000, being the amount of dividends in that year paid to its stockholders by the Alton Railroad. The resulting tax of $14,437.50 was paid for the plaintiff by the Alton Company. An additional assessment of $1,985.16 for the year 1932, based on the same grounds as the deficiency proposed for the year 1931, was also asserted by said letter of November 28, 1933, and together with interest at $91.62 (said amounts having been assessed by the Commissioner of Internal Revenue on December 22, 1933) was likewise paid on January 8, 1934, to the said J. Enos Ray by the Alton Company.

IX.

For the years 1933 and 1934, the plaintiff filed an income tax return on or before March 15 of the respective succeeding years, reporting as its income for such years the amounts of payments to plaintiff's stockholders and of the income tax imposed thereon. The resulting tax

55 amounted to $16,422.66 for each of said years and was paid for the plaintiff by the Alton Company. All the payments, except the said additional assessments, were made in quarterly installments. All of said amounts were assessed by the Commissioner of Internal Revenue. The dates and amounts of such quarterly payments, the dates the assessments were made, and the several Collectors of Internal Revenue at Baltimore, Maryland, to whom they were paid, are as follows:

Year	Date Assessed	Amount	Date Paid	Amount	To whom paid
1932	Apr. 1933	$14,437.50	3/15/33	$3,609.38	Galen L. Tait
			6/15/33	3,609.38	Galen L. Tait
			9/15/33	3,609.38	J. Enos Ray
			12/15/33	3,609.36	J. Enos Ray
1933	Apr. 1934	16,422.66	3/15/34	4,105.67	J. Enos Ray
			6/15/34	4,105.67	J. Enos Ray
			9/15/34	4,105.67	Lewis H. Melbourne, Acting Collector
			12/15/34	4,105.65	Lewis H. Melbourne, Acting Collector
1934	Apr. 1935	16,422.66	3/15/35	4,105.67	Lewis H. Melbourne
			6/15/35	4,105.67	" " "
			9/14/35	4,105.67	" " " Acting Collector
			12/16/35	4,105.65	M. Hampton Magruder

The term of office of said Collector Galen L. Tait terminated on July 4, 1933; of said Collector J. Enos Ray on September 10, 1934, and of said Acting Collector Louis H. Melbourne on September 17, 1935. The said Collector M. Hampton Magruder was the Collector of Internal Revenue on the date of the filing of the bill of complaint herein.

X.

On June 13, 1935, plaintiff filed claims for refund of the additional assessment of $1,512 paid for the year 1931, and for the full amount of the taxes paid for the years 1932 and 1933, in each case with interest thereon, with the Collector of Internal Revenue at Baltimore, Maryland. The same were rejected by registered letter of the Commissioner of Internal Revenue dated June 21, 1937. Plaintiff also filed on April 27, 1936, a claim for refund of the tax
56 so paid for the year 1934, with interest, with the Collector of Internal Revenue at Baltimore, Maryland. Such claim was rejected by registered letter of the Commissioner of Internal Revenue dated July 13, 1937.

XI.

During the years in question the books of the plaintiff as well as those of the Alton Company and its predecessor, were maintained pursuant to the classification of accounts for steam roads prescribed by the Interstate Commerce Commission, in accordance with Section 20 of the Act to Regulate Commerce. Such classification requires plaintiff to maintain an account designated "Income from lease of road", and during the years in question this account reflected the amount of the dividends paid by the Alton Company and its predecessor to the plaintiff's stockholders as such income, and during the years 1933 and 1934 this account also reflected the amount of income taxes thereon. Correspondingly, such classification required the Alton Company and its predecessor to maintain an account designated "Rent for leased roads", and the payments of such dividends and all the income taxes thereon assessed against plaintiff were reflected in such account. In the income taxe returns filed by the Alton Company deductions were taken for the amounts paid to the plaintiff's stockholders.

57 Conclusions of Law.

I.

That all the payments made during the years 1931 to 1934, inclusive, by the Alton Railroad Company or its predecessor to the plaintiff's stockholders of a seven per cent (7%) annual dividends on the stock, pursuant to the lease agreement entered into on January 1, 1864, constituted income to the plaintiff in the year in which said payments were made.

II.

That the payments by the Alton Railroad Company during the years 1931 to 1934, inclusive, of income taxes assessed against the plaintiff for those years, were in discharge of an obligation of the plaintiff and hence constituted income to the plaintiff in the year in which the payments were made.

III.

That the assessments and payment of all of the taxes in question in these actions were proper under the law and that plaintiff is not entitled to recover.

IV.

That judgment should be entered against the plaintiff and in favor of the defendant.

Enter:

Igoe,
Judge.

58 And afterwards, to wit, on the 13th day of May A. D. 1940, being one of the days of the regular May term of said Court, in the record of proceedings thereof, in said entitled cause, before the Honorable Michael L. Igoe, District Judge, appears the following entry, to wit: JUDGMENT: Entered May 13, 1940.

59 In the District Court of the United States.

* * (Captions—692-693) * *

Monday, May 13, 1940.

Present: Hon. Michael L. Igoe, District Judge.

The Court having heretofore heard the arguments of counsel and having considered the statement of facts submitted and being now fully advised in the premises finds the issues for the defendant, United States of America. Therefore It Is Considered by the Court that the Plaintiff, Joliet and Chicago Railroad Company take nothing by its aforesaid action that the defendant United States of America go hence without day.

Filed Aug. 10, 1940. 60 And on, to wit, the 10th day of August, 1940, came the Plaintiff by its attorneys and filed in the Clerk's office of said Court its certain Notice of Appeal in words and figures following, to wit:

61 APPEAL TO THE CIRCUIT COURT OF APPEALS FOR THE SEVENTH CIRCUIT, FROM THE DISTRICT COURT OF THE UNITED STATES,

Northern District of Illinois,

Eastern Division.

Joliet & Chicago Railroad Company, *Plaintiff-Appellant,* vs. United States of America, *Defendant-Appellee.*	Consolidated Civil Action Nos. 692 and 693.

NOTICE OF APPEAL.

Notice Is Hereby Given that Joliet & Chicago Railroad Company, plaintiff above named, hereby appeals to the Circuit Court of Appeals for the Seventh Circuit from the final judgment entered in this action May 13, 1940.

Frank H. Towner,
Edward G. Ince,
Arthur D. Welton, Jr.,
Attorneys for Appellant, Joliet & Chicago Railroad Company,
38 South Dearborn Street, Chicago, Illinois.

64 And on, to wit, the 10th day of August, 1940, came the Plaintiff-Appellant by its attorneys and filed in the Clerk's office of said Court its certain Statement of Points in words and figures following, to wit:

65 THE DISTRICT COURT OF THE UNITED STATES. Filed Aug. 1940.
• • (Captions—692-693) • •

STATEMENT OF POINTS.

The above named plaintiff asserts, and intends to urge, that in entering final judgment herein the court erred in the following respects:

1. In concluding, as a matter of law, that all the payments made during the years 1931 to 1934, inclusive, by The Alton Railroad Company or its predecessor to the plaintiff's stockholders of a 7% annual dividend on the stock, pursuant to the lease agreement entered into on January 1, 1864, constituted income to the plaintiff in the year in which said payments were made.

2. In concluding, as a matter of law, that the payments by the Alton Railroad Company during the years 1931 to 1934, inclusive, of income taxes assessed against the plaintiff for those years, were in discharge of an obligation of the plaintiff and hence constituted income to the plaintiff in the year in which the payments were made.

3. In concluding, as a matter of law, that the assessments and payment of all of the taxes in question in those actions were proper under the law and that plaintiff is not entitled to recover.

4. In concluding, as a matter of law, that judgment should be entered against the plaintiff and in favor
66 of the defendant.

5. In failing to conclude, as a matter of law, that the indenture of January 1, 1864 effectively conveyed the fee simple ownership to the property at that time belonging to the plaintiff (and to any other property thereafter acquired) to the grantee therein named, its successors and assigns, and effectively divested plaintiff of all title thereto.

6. In failing to conclude, as a matter of law, that the indenture of January 1, 1864 also served to divest plaintiff of all control over the dividends guaranteed therein to be paid to plaintiff's stockholders, and that the said dividends are subject to tax only as income received by plaintiff's stockholders as individuals.

7. In failing to conclude, as a matter of law, that since the plaintiff owns no property and since the right

to receive dividends upon its stock is irrevocably vested in plaintiff's stockholders and not subject to plaintiff's control that the payment of such dividends to plaintiff's stockholders does not constitute the amount of such payments taxable income to the plaintiff.

8. In failing to conclude, as a matter of law, that the plaintiff was not in receipt of any income during the years 1931 to 1934, inclusive.

9. In failing to conclude, as a matter of law, that the plaintiff is entitled to refund of the amounts of income taxes paid for it subsequent to March 15, 1933 as follows:

Date of Payment:	Amount:
June 15, 1933	$3,609.38
September 15, 1933	3,609.38
December 15, 1933	3,609.36
67 January 8, 1934	1,672.50
January 8, 1934	2,076.78
March 15, 1934	4,105.67
June 15, 1934	4,105.67
September 15, 1934	4,105.67
December 15, 1934	4,105.65
March 15, 1935	4,105.67
June 15, 1935	4,105.67
September 11, 1935	4,105.67
December 16, 1935	4,105.65,

together with interest on each of said amounts from the date of payment at the rate of 6% per annum.

10. In entering judgment in favor of the defendant and against the plaintiff.

11. In failing to enter judgment in favor of the plaintiff and against the defendant for the amounts listed in item 9 above, together with interest on each of said amounts from the date of payment at the rate of 6% per annum.

Joliet & Chicago Railroad Company,
By Frank H. Towner,
Edward G. Ince,
Arthur D. Welton, Jr.,
Its Attorneys.

62 And on, to wit, the 10th day of August, 1940, came the Plaintiff-Appellant by its attorneys and filed in the Clerk's office of said Court its certain Cost Bond on Appeal in words and figures following, to wit: Filed Aug. 1 1940.

63 COST BOND ON APPEAL.

Know All Men by These Presents: That we, Joliet & Chicago Railroad Company, an Illinois corporation, as principal, and H. B. Voorhees, as surety, are held and firmly bound unto the United States of America in the full and just sum of Two Hundred Fifty Dollars ($250) to be paid to the said United States of America; to which payment, well and truly to be made, we bind ourselves, our heirs, executors, and administrators, jointly and severally, firmly by these presents. Sealed with our seals and dated this 7th day of August, in the year of our Lord one thousand nine hundred and forty.

Whereas, lately at a session of the District Court of the United States, for the Northern District of Illinois, Eastern Division, in a suit pending in said Court between Joliet & Chicago Railroad Company, plaintiff, and the United States of America, defendant, a decree was rendered against the said Joliet & Chicago Railroad Company, and the said Joliet & Chicago Railroad Company having filed its notice of appeal to the United States Circuit Court of Appeals for the Seventh Circuit in the Clerk's Office of the said District Court to reverse the decree of the aforesaid suit.

Now, the condition of the above obligation is such, that if the said Joliet & Chicago Railroad Company shall prosecute its said appeal to effect, and shall answer all costs that may be awarded against it if it fails to make its plea good, then the above obligation to be void; otherwise to remain in full force and virtue.

Joliet & Chicago Railroad Company,
By H. B. Voorhees,
Vice-President.

(Corporate Seal)

H. B. Voorhees (Seal)
As Surety.

Attest:
J. Williams,
Assistant Secretary.

Filed Aug. 10, 1940. 68 And on, to wit, the 10th day of August, 1940, came the Plaintiff-Appellant by its attorneys and filed in the Clerk's office of said Court its certain Designation of Content of Record on Appeal in words and figures following, to wit:

69 IN THE DISTRICT COURT OF THE UNITED STATES.

* * (Captions—692-693) * *

DESIGNATION OF CONTENT OF RECORD ON APPEAL.

The above named plaintiff hereby designates the following to be included in the record on appeal in the above entitled case:

1. Complaint in case 692.
2. Complaint in case 693, excepting Exhibit A thereto.
3. Answer in case 692.
4. Answer in case 693.
5. Order of March 1, 1940, consolidating cases.
6. Stipulation of facts, excepting Exhibit A thereto.
7. Findings of fact and conclusions of law.
8. Judgment.
9. Notice of appeal.
10. Costs bond.
11. Statement of points.
12. Designation of content of record on appeal.

Joliet & Chicago Railroad Company,
By Frank H. Towner,
Edward G. Ince,
Arthur D. Welton, Jr.,
Its Attorneys.

Received a copy of the above designation of content of record on appeal this 10 day of August, 1940.

Wm. J. Campbell (per E C)
United States Attorney.

70 Northern District of Illinois } ss.
Eastern Division }

I, Hoyt King, Clerk of the District Court of the United States for the Northern District of Illinois, do hereby certify the above and foregoing to be a true and complete transcript of the proceedings had of record made in accordance with praecipe filed in this Court in the cause entitled

Joliet & Chicago Railroad Company } Consolidated
vs. } Nos. 692 and 693.
United States of America.

as the same appear from the original records and files thereof now remaining in my custody and control.

In Testimony Whereof, I have hereunto set my hand and affixed the seal of said Court at my office, in the City of Chicago, in said District, this 14th day of September, A. D. 1940.

Hoyt King,
Clerk.

(Seal)

At a regular term of the United States Circuit Court of Appeals for the Seventh Circuit held in the City of Chicago, and begun on the third day of October, in the year of our Lord one thousand nine hundred and thirty-nine, and of our Independence the one hundred and sixty-fourth.

No. 7458

JOLIET & CHICAGO RAILROAD COMPANY, PLAINTIFF-APPELLANT

vs.

THE UNITED STATES OF AMERICA, DEFENDANT-APPELLEE

Appeal from the District Court of the United States for the Northern District of Illinois, Eastern Division

And, to wit: On the tenth day of March 1941, there was filed in the office of the Clerk of this Court the opinion of the Court, which said opinion is in the words and figures following, to wit:

In the United States Circuit Court of Appeals for the Seventh Circuit

No. 7458

October Term, 1940, January Session, 1941

JOLIET & CHICAGO RAILROAD COMPANY, PLAINTIFF-APPELLANT

vs.

THE UNITED STATES OF AMERICA, DEFENDANT-APPELLEE

Appeal from the District Court of the United States for the Northern District of Illinois, Eastern Division

March 10, 1941

Before SPARKS, MAJOR, and KERNER, Circuit Judges.

MAJOR, Circuit Judge. This is an appeal from a judgment, entered May 13, 1940, disallowing a claim to recover income taxes paid for the years 1931 to 1934 inclusive, in the aggregate amount of $50,799.98, plus interest.

On January 1, 1864, the plaintiff, being the owner of thirty-seven miles of railroad between the cities of Joliet and Chicago,

Illinois, entered into an indenture, under which it granted, demised and leased the railroad, together with all the appurtenances thereof, to the Chicago and Alton Railroad Company, its successors and assigns, without reservation, forever. The indenture contained no provision under which the tenure of the grantee therein could be terminated for failure to perform any of the covenants thereof, nor did it contain any provision for the payment of rent to the grantor. In consideration therefor, the Chicago and Alton Railroad Company obligated itself to guarantee and pay to the plaintiff's stockholders forever, in quarterly installments, an annual dividend of seven percent per share on the par value of all outstanding capital stock. For the purpose of paying such dividend it further obligated itself to deposit with the United Trust Company of New York, funds sufficient therefor. In addition to these payments, the Chicago and Alton was required to pay any and all Federal taxes that might arise because of the payment of the dividend. A statement of these guaranteed payments was printed on all stock certificates issued by the plaintiff company. The number of outstanding shares was limited to fifteen thousand, having a par value of $100 per share, so that the annual payment required was $7.00 per share, or a total of $105,000 per year. This amount, beginning in 1864, was paid every year, including the years 1931 to 1934 inclusive. In addition to that, the Chicago and Alton Railroad Company and its successor, the Alton Railroad Company, paid the income taxes of the plaintiff in the amount of approximately $16,000 for each of the years involved. During these years, no resolutions declaring dividends were adopted by plaintiff's Board of Directors.

It is the contention of plaintiff that the indenture of 1864, being a lease in perpetuity and containing no defeasance clause, effectively conveyed to the grantee therein, its successors and assigns, all right, title and interest in the property. Therefore, the plaintiff, having divested itself of all of its property absolutely and, also, all control over and right to the payments made to the stockholders by the grantee, is not, and cannot be in receipt of income, actually or constructively.

The defendant, on the other hand, without conceding that the agreement was a conveyance in fee, argues that such a construction is immaterial inasmuch as the payments were received by the plaintiff's stockholders by virtue of their stock rights, and, consequently, such money is income constructively received by the plaintiff.

The indenture of 1864 is what is commonly called a lease in perpetuity. Such an instrument, however, can effectively con-

vey a fee, if its terms are sufficiently broad to warrant such an interpretation. The interest conveyed will be determined by the habendum, for it is the purpose of this part of the instrument to define the nature and quality of the estate taken by the grantee. Jamaica Pond Aqueduct Corp. v. Chandler, 91 Mass. 159. The habendum in the present instrument is as follows:

"To have and to hold, the said above demised and leased premises, together with all the appurtenances thereof without reservation, * * * Forever, * * *"

The grantor in this instrument has parted without reservation with all interest in the property. A reading of the instrument discloses that while it is called a lease, it has none of the characteristics thereof. There is no termination of the length of time the grantee is to hold the estate, no reservation of rent, no defeasance, and no right to reenter on default by the grantee. The importance of the lack of the defeasance clause is noted in State v. Mississippi River Bridge Co., 35 S. W. 592, 596:

"* * * Since the bridge company, as against the defendant railroad company, under the ruling in the case of State v. Mississippi River Bridge Co., 109 Mo. 253, 19 S. W. 421, is held to be the owner of the bridge, by reason of the defeasance clause in the lease from the bridge company to the defendant railroad company, by reason of a lack of a similar clause in the contract entered into between the Louisiana & Missouri River Railway Company and the bridge company, the defendant railroad company, as the assignee of the Louisiana & Missouri River Railway Company, cannot now be considered t be the owner of the bridge. * * *"

The indenture in the instant case was considered in Huck, et al. v. Chicago & Alton Railroad Co., 86 Ill. 352, where the court, at page 354, said:

"We think it clear, from the corporate powers conferred by its charter, the terms of the leases and the provisions of the revenue law referred to, that the Chicago & Alton Railroad Company is, for all purposes of taxation, at least, if not for all other purposes, to be regarded as the owner of all the leased property. * * *"

Thus, there is little, if any, question that the indenture of 1864 divested the plaintiff of all right, title and interest in the property, and vested a full and indefeasible title in the grantee, its successors and assigns. Chicago, Burlington & Quincy Railroad Co. v. Boyd, 118 Ill. 73.

The defendant does not seriously contend to the contrary, but points out that the parties treated the situation as one of a lessor-lessee relationship in that they entered the payments in

question on the books as "income from lease of road" in one case and "rent for lease of road" in the other. Such entries, however, can not be termed a voluntary admission on the part of the parties because made in accord with a classification established by the Interstate Commerce Commission. (Sec. 20 of the Act to Regulate Commerce.) Under such circumstances it can not be said that their acts in this respect amount to an interpretation by the parties. The defendant further contends that the requirement that the grantee should, at its own cost and expense, keep the road in good repair and working order, is inconsistent with a fee conveyance. In view of what we have said, we are of the opinion that this isolated provision does not amount to a defeasance clause, and that it is not inconsistent with a fee grant.

Defendant further contends that it is immaterial if the indenture be construed as an outright conveyance of the property; that the payments made to the stockholders, whatever they be termed, are still income to the plaintiff because the payments are the consideration for the conveyance, and, consequently, are earned by the corporation. This contention, in our judgment, presents the real issue in controversy. The authorities relied upon by the defendant in substantiation of this position are the so-called "constructive receipt" cases. In Gold & Stock Telegraph Co. v. Commissioner, 83 F. (2d) 465, the agreement was for a term of 99 years, and the taxpayer, in case of default in payment, had the option to terminate the agreement and to resume possession of the property. The property was to be surrendered in good condition at the end of the term, and the lessee agreed to pay, as an annual rental, six per cent on the capital stock of the taxpayer direct to the stockholders of the taxpayer. The court, on page 467, said:

"* * * Had all future rentals been assigned by the lessor to the stockholders, the case would have been different from that before us. * * *"

The situation in United States v. Northwestern Telegraph Co., 83 F. (2d) 468, and Pacific & Atlantic Telegraph Co. v. Commissioner, 83 F. (2d) 469, is substantially similar, the leases being for terms of 99 years and 999 years, respectively. In the former case, the court, on page 469, said:

"* * * The liability is because the property, which belongs to whoever may be the stockholders as associates in corporate form, produces the income that passes to the recipients only as stockholders. * * *"

In Rensselaer & S. R. Co. v. Irwin, 249 Fed. 726, the agreement was a lease for 500 years, in which the lessee agreed

to pay as annual rental, interest to the bondholders, and dividends to the stockholders of the lessor, for the term of the lease. The court, on page 727, states:

"* * * The lessee from 1871 down to the present time has continued to be in possession of the lessor's properties and franchises; * * *"

The latter case, it is true, was cited with approval by the Supreme Court in Old Colony Trust Co. v. Commissioner, 279 U. S. 716, 729, but this approval was limited to the proposition that income taxes paid by a lessee for a lessor are income to the lessor. It throws no light on the question as to whether the income paid to the stockholders is income of the lessor corporation.

It is plainly evident in each of the cases relied upon by the defendant that title to the property producing the income remained in the lessor, and that the income was derived from rent paid by the lessee for the use of the property held by the lessor for the benefit of its stockholders. In the instant situation, however, the plaintiff owns no property, is without power upon default to take over the property demised by the so-called lease is not actually in receipt of income, and is without authority to require payment to it. Neither can the grantee discharge its obligation under the agreement by payment to the plaintiff—in fact the latter is without right to accept such payment.

Thus, by the terms of the indenture, the stockholders of plaintiff were made donee beneficiaries of the grantee's promise, given in consideration of the conveyance; they may sue the grantee for the sums contracted to be paid them, and the plaintiff is without power to destroy their rights in this respect. Western Union Telegraph Co. v. Commissioner, 68 F. (2d) 16. The corporations in the so-called "constructive receipt" cases were links in the income-receiving chain; the income was produced from the use of their property. In the instant case where plaintiff had long before divested itself of ownership, dominion, and control of such property, we think the chain has been broken—in fact, the link has vanished. Here the promise of the grantee inured to the benefit of the stockholders by force of the agreement. Bay v. Williams, 112 Ill. 91. The income is received by them is of negligible value. In each case control by X over the income of any further benefits that may be conferred upon them by the plaintiff. Their rights are fixed by contract rather than by their status as stockholders.

The indenture agreement of 1864 did two things—(1) it put the ownership of all the corporate assets, together with any income therefrom, irrevocably out of the hands of the plaintiff

and into the hands of the grantee, and (2) it created a contractual obligation in favor of the shareholders, definite in amount, and in their right of enforcement. By this agreement, the shareholders succeeded to all the right which plaintiff might otherwise have had to this income, and, therefore, it is their income and not that of the plaintiff, either actually or constructively.

The decision of the District Court is reversed.

KERNER, Circuit Judge.

I regret that I am unable to concur in the opinion of my associates. Their opinion lays stress and is based entirely on the status of the stockholders as third party beneficiaries and the lack of control of the corporate taxpayer over the income. The opinion seems to ignore what in my opinion is a vital factor in the conclusion to be reached, the relationship between taxpayer and stockholders. At the most, that the stockholders may sue directly as third party beneficiaries on the promisor's undertaking, is of little consequence and emphasis thereon tends only to confuse the issue. Moreover, I do not believe that the doctrine of constructive receipt is governed solely by the "control of income" test, nor is it my impression that the federal courts have been imposing tax liability with regard to that test exclusively. Apparently the majority opinion indorses the statement in Northwestern Telegraph Co. v. Wisconsin Tax Commission, 248 N. W. (Wis.) 164, 166, that "the test is control over that which is taxed." I think the Wisconsin Supreme Court's view of constructive receipt is very narrow and has not won recognition by the federal courts, Gold & Stock Telegraph Co. v. Commissioner, 83 F. (2) 465, 467.

Corporation X transfers railroad property to Corporation Y in consideration of the payment of fixed amounts ("dividends") to the stockholders of Corporation X. Let us suppose a transfer (1) by lease for 999 years, (2) by perpetual lease lacking a defeasance clause, and (3) by perpetual lease containing a defeasance clause. In each case the question is whether the amounts so paid the stockholders, which X never actually receives, constitutes income to X. In cases (1) and (3) the reversion, separated as it is from the consideration, is of questionable value. In case (2) the reversion, if any, separated as it is from the consideration, is of negligible value. On each case control by X over the income has been relinquished. See Concurring Opinion, Harwood v. Eaton, 68 F. (2) 12, 14. In each case X had control of the disposition of income and could have received it, but at the time of payment the stockholders were legally entitled to it and actually received it.

In case (1) it is conceded that X is the taxable person. Pacific & Atlantic Telegraph Co. v. Commissioner, 83 F. (2) 469. In case (2) the majority opinion holds that X is not taxable. In case (3) I believe that the majority opinion would be compelled to hold X taxable. It follows that either the law conceded to be controlling in (1) is not correct or that the law applied by the majority opinion in (2) is erroneous. Manifestly this is true, for the majority opinion turns the case mainly on the element of control over income and it is a fact that in the three cases corporate control over the income has been relinquished. It is my conclusion that the majority opinion has relied unduly on the presence or absence of a defeasance clause and hence has sacrificed substance at the altar of form.

Various theories have been advanced for the result reached in case (1) above. Rensselaer & S. R. R. Co. v. Irwin, 239 F. 739, aff'd, 249 F. 726, cert. den., 246 U. S. 671; Blalock v. Georgia Ry. & Elec. Co., 246 F. 387; West End St. Rv. Co. v. Malley, 246 F. 625, cert. den., 246 U. S. 671. The substance of the arguments used by the federal courts center around the relationship between the corporate taxpayer and its stockholders. The rationale of these opinions apply as well to cases (2) and (3) as to case (1) and the same result should be reached in each case. As stated in Gold & Stock Telegraph Co. v. Commissioner, 83 F. (2) 465, 467, "As theh lessor corporation still exists to serve its stockholders for some purposes, we think it reasonable to treat it as a link in the income receiving chain which should not be disregarded as a taxpayer." Judge Learned Hand reasons that in cases such as these, there is a necessity for disregarding the corporate entity entirely and simply regarding payments to stockholders as payments to the corporation. Concurring Opinion, Harwood v. Eaton, 68 F. (2) 12, 14–15. See also Gold and Stock Telegraph Co. case, 26 B. T. A. 914, 927; Kansas City, St. L. & C. R. R. Co. v. Commissioner, B. T. A. case promulgated November 6, 1940. Some of the courts above are also influenced in their opinions by the fear that a contrary view would open the door to future circumvention of the corporate income tax.

It is clear in our case that the rights of the stockholders to the payments of income spring from their status as members of the transferor corporation and that these payments could only have been made because the corporation was under an existing obligation to distribute earnings not required for its business. See also Raynolds v. Diamond Mills Paper Co., 60 Atl. (N. J. Eq.) 941; Dodge v. Ford Motor Co., 170 N. W. (Mich.) 668. I believe that either the payments to the stockholders should be treated as

dividend distributions, or that in thus obtaining the discharge of an obligation definitely owing to its stockholders it received something of value which can property be treated as income to it. In either event the income received by the stockholders should be treated as income of the corporation for purposes of the tax.

I believe that the judgment of the District Court should be affirmed.

A true Copy:

Teste:

And, on the same day, to wit: On the tenth day of March 1941, the following further proceedings were had and entered of record, to wit:

Monday, March 10, 1941

Court met pursuant to adjournment.

Before Hon. WILLIAM M. SPARKS, Circuit Judge; Hon. J. EARL MAJOR, Circuit Judge; Hon. OTTO KERNER, Circuit Judge.

No. 7458

JOLIET & CHICAGO RAILROAD COMPANY, PLAINTIFF-APPELLANT

vs.

THE UNITED STATES OF AMERICA, DEFENDANT-APPELLEE

Appeal from the District Court of the United States for the Northern District of Illinois, Eastern Division

This cause came on to be heard on the transcript of the record from the District Court of the United States for the Northern District of Illinois, Eastern Division, and was argued by counsel.

On consideration whereof, it is ordered and adjudged by this Court that the judgment of the said District Court in this cause appealed from be, and the same is hereby, reversed, and that this cause be, and it is hereby, remanded to the said District Court.

United States Circuit Court of Appeals for the Seventh Circuit

I, Kenneth J. Carrick, Clerk of the United States Circuit Court of Appeals for the Seventh Circuit, do hereby certify that the foregoing typewritten and printed pages contain a true copy of the opinion and judgment of this Court in the following entitled cause: Cause No. 7458, Joliet & Chicago Railroad Company, plaintiff-appellant vs. The United States of America, De-

fendant-appellee, as the same remains upon the files and records of the United States Circuit Court of Appeals for the Seventh Circuit.

In testimony whereof I hereunto subscribe my name and affix the seal of said United States Circuit Court of Appeals for the Seventh Circuit, at the City of Chicago, this sixteenth day of May A. D. 1941.

[SEAL] KENNETH J. CARRICK,
Clerk of the United States Circuit Court
of Appeals for the Seventh Circuit.

U. S. GOVERNMENT PRINTING OFFICE: 1941

Supreme Court of the United States

Order allowing certiorari

Filed October 13, 1941

The petition herein for a writ of certiorari to the United States Circuit Court of Appeals for the Seventh Circuit is granted.

And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.

U. S. GOVERNMENT PRINTING OFFICE: 19